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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 28065

PASS TO FEDERAL RESERVE AND COMMERCE

E. O. 11652: GDS
TAGS: EFIN, FR
SUBJECT: ANALYSIS OF THE BARRE PLAN

1. SUMMARY

THE BARRE PLAN CAN BE CHARACTERIZED AS A TOUCH ON THE BRAKE (THE PARTLY ONE-SHOT RISE IN TAXES) FOLLOWED BY A LIGHTER FOOT ON THE ACCELERATOR (FISCAL EQUILIBRIUM AND A 12.5 PERCENT RATE OF GROWTH OF THE MONEY SUPPLY IN 1977). THE REST OF THE PLAN IS GEARED TO THE POLITICAL REQUIREMENTS OF EQUITY IN PRINCIPLE AND FAIRNESS IN APPLICATION. THUS, IF THE ASSEMBLY VOTES THE BUDGET MEASURES, IT WILL HAVE
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PUT THE ESSENTIAL BARRE PLAN IN PLACE. ALL THE

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REST CAN BE AND PROBABLY WILL BE DEBATED, MODIFIED, AND EVEN REJECTED IN SOME ASPECTS.

IN AGGREGATE DEMANDTERMS THE BARRE PROGRAM IMPLIES A RELATIVELY SLOW OVERALL RATE OF ECONOMIC GROWTH IN 1977 BUT AT A LEVEL SUFFICIENT TO SUSTAIN EMPLOYMENT AT LEAST AT PRESENT LEVELS. NO STRONG INCREASE IN TOTAL INVESTMENT IS FORESEEN. BY IMPLICATION A SWING IN INVENTORIES PLUS AN EXPECTATION OF RISING EXPORTS IS COUNTED ON TO KEEP TOTAL DEMAND SUFFICIENTLY HIGH TO MAINTAIN EMPLOYMENT. THE RATE OF CONSUMPTION (4.1) IS EXPECTED TO REMAIN ABOUT THE SAME AS THIS YEAR, WHILE IMPORTS ARE EXPECTED TO MODERATE MAINLY AS THE RESULT OF ENERGY MEASURES AND SOME SLOWDOWN IN THE RATE OF IMPORTS OF PRODUCER GOODS.

THE BARRE PLAN RESTS ON THREE ESSENTIAL POINTS. ONE, SUFFICIENT ACCEPTANCE IN THE NATION TO BE SUSTAINED FOR THE NECESSARY TIME, ABOUT ONE YEAR. TWO, A CONTROL OF PUBLIC SPENDING, SINCE TAX MEASURES HAVE NOT BEEN SUFFICIENT TO CHANGE THE BASIC RELATIONSHIP BETWEEN TRENDS IN PUBLIC SPENDING AND RECEIPTS IN RECENT YEARS. AND, THREE, MEETING THE MONETARY TARGET WHICH IS PARTLY DEPENDENT UPON THE CONTROL OF PUBLIC SPENDING. IN ALL THESE ASPECTS IT IS MUCH TOO EARLY TO ASSESS THE LIKELIHOOD OF SUCCESS. HOWEVER, IT SEEMS CERTAIN THAT THE BUDGET MEASURES WILL GET THE NECESSARY ASSEMBLY VOTES AND THAT THE BARRE PLAN WILL BE PUT IN PLACE. AFTER THAT, THE FATE OF THE BARRE PLAN AS A STABILIZATION PROGRAM WILL DEPEND UPON THE COSISTENCY AND DURATION WITH WHICH IT IS ADMINISTERED. SUCH CONSISTENCY IN ECONOMIC POLICY HAS YET TO BE DEMONSTRATED BY THE GOF. THIS IS PROBABLY THE LARGEST SINGLE QUESTION MARK, AND THE OPPOSITION CAN BE EXPECTED TO TEST THE GOF'S RESOLVE IN THE COMING MONTHS. END SUMMARY.

2. ECONOMIC ENVIRONMENT AND EXPECTATIONS FOR 1977
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THE ECONOMIC RECOVERY THAT BEGAN IN FRANCE LAST YEAR HAS BEEN FOR ALL PRACTICAL PURPOSES ABORTED BY AN INFLATION WHICH RESUMED AT THE FIRST SIGNS OF THE UPTURN. SPECIFICALLY, THE INITIAL RISE IN CONSUMPTION WAS NOT FOLLOWED BY THE EXPECTED CHANGES IN INVENTORIES, EXCEPT IN THE AUTOMOTIVE SECTOR, AND INVESTMENT HAS REMAINED

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STAGNANT OR WORSE IN REAL TERMS. IN SUCH CIRCUM-
STANCES CONTINUED INFLATION COULD CAUSE A RELATIVE
DECLINE IN CONSUMPTION LEADING AGAIN, AS IN 1974,
TO RECESSION OR, AT BEST, STAGNATION. SUCH
DEVELOPMENTS WOULD BE A SOCIO-ECONOMIC DISASTER
FOR THE GOF WITH STRONGLY ADVERSE POLITICAL
CONSEQUENCES. THUS, THE GOF HAS IDENTIFIED
INFLATION AS FRANCES'S PUBLIC ENEMY NUMBER ONE.

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AS LONG RECOGNIZED BY SOME OF THE COUNTRY'S LEADING
POLITICIANS. THE BARRE PLAN IS A STABILIZATION
PROGRAM IN THAT IT ENVISIONS A STANDSTILL INSOFAR
AS RATES OF ECONOMIC GROWTH ARE CONCERNED WHILE
INFLATION IS REDUCED TO THE OBJECTIVE OF 6.5 PERCENT

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AT AN ANNUAL RATE BY FISCAL AND MONETARY MEASURES.

THE PRINCIPAL ECONOMIC ASSUMPTIONS IN THE 1977 BUDGET ARE EXPLICIT IN THIS RESPECT:

REAL RATES OF GROWTH FROM 1976 TO 1977

GROSS INTERNAL PRODUCT PLUS 4.8 PERCENT
CONSUMPTION PLUS 4.1 PERCENT
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INVESTMENT PLUS 3.1 PERCENT
IMPORTS PLUS 7.1 PERCENT
EXPORTS PLUS 9.3 PERCENT

THE ABOVE RATES, EXCEPT FOR INVESTMENT AND IMPORTS, ARE ROUGHLY COMPARABLE TO CURRENT TRENDS IN THE ECONOMY. IMPORTS MAY REMAIN HIGHER THAN THIS FORECAST AND INVESTMENT PROBABLY WILL REMAIN LOWER. HOWEVER, INSOFAR AS THE LEVEL OF TOTAL DEMAND IN THE ECONOMY IS CONCERNED, CHANGES IN INVENTORY, WHICH ARE NOT INCLUDED IN BUDGET ESTIMATES, COULD BE A SIGNIFICANT ELEMENT IN KEEPING TOTAL DEMAND SUFFICIENTLY HIGH TO PREVENT A WORSENING OF UNEMPLOYMENT AND POSSIBLY A SIGNIFICANT REDUCTION OF UNEMPLOYMENT COULD OCCUR IN 1977. THE AUTHORITIES PROBABLY ARE COUNTING ON THE MUCH DELAYED INVENTORY SWING TO SUSTAIN DEMAND, PARTICULARLY AS THEY ARE ANYTHING BUT CONFIDENT ABOUT THEIR INVESTMENT PROJECTIONS.

IN SUMMARY, THE BARERE PLAN ADMITS THAT FRANCE CANNOT RETURN TO ANYTHING LIKE NORMAL ECONOMIC GROWTH RATES, OR THOSE PROJECTED UNDER THE SEVENTH PLAN (5.7 PERCENT), UNTIL INFLATION IS SUBSTANTIALLY REDUCED.

3. THE STRUCTURE OF THE BARRE PLAN

THERE ARE TWO FACETS OF THE BARRE PLAN. THE ESSENTIALS ARE CONTAINED IN THE SUPPLEMENTAL BUDGET FOR 1976 AND THE BUDGET FOR 1977, PLUS THE MONETARY TARGETS OUTLINED IN THE PROGRAM TO COMBAT INFLATION. SIGNIFICANTLY, THIS ESSENTIAL PLAN INCORPORTATES THE PROGRAM FOR DROUGHT RELIEF AND MEASURES TO REDRESS SOCIAL SECURITY FINANCES BY WHICH GOF HAS MOVED TO DEFUSE THE EMOTIONAL DEBATE ABOUT WHO SHOULD PAY THE FARMERS AND HOW THE SOCIAL SECURITY DEFICIT SHOULD BE RESOLVED.

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THE REMAINDER OF THE PROGRAM DEALING WITH
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PRICE, WAGES, RENTS, THE TAX ON PETROLEUM
PRODUCTS, A VARIETY OF FISCAL MEASURES RELATING
TO CORPORATE FINANCE, FINANCIAL MARKETS, SMALL
AND MEDIUM-SIZED ENTERPRISES, CREDITS FOR
INVESTMENT BY PUBLIC ENTERPRISES, REGIONAL
PUBLIC ENTERPRISES AND VARIOUS ADMINISTRATIVE
MEASURES ARE DESIGNED TO GIVE THE PROGRAM A
COMPREHENSIVE CHARACTERISTIC AND A SENSE OF
EQUITY AND FAIRNESS, THEY ARE BASICALLY SECONDARY
TO THE MAJOR PURPOSE OF THE PLAN--THE STABILIZA-
TION OF THE FRENCH ECONOMY. MANY OF THEM WILL BE
PRESENTED AS SEPARATE ACTIONS TO THE NATIONAL
ASSEMBLY.

POSSIBLY THIS STRUCTURE INDICATES A PARLIAMENTARY
STRATEGY. THE BUDGET USUALLY RECEIVES MORE
COHESIVE SUPPORT BY THE MAJORITY PARTIES THAN
INDIVIDUAL PROGRAMS. MOREOVER, SOCIAL SECURITY
AND DROUGHT MEASURES CAN BE PRESENTED IN THE
CONTEXT OF THE BUDGET FOR THE NATIONS AS A
WHOLE, RATHER THAN AS SEPARATE PROGRAMS. MEANWHILE,
DEBATE COULD DEVELOP AROUND THE NONESSENTIAL MEASURES
THAT WILL BE PRESENTED INDIVIDUALLY.

IN ANY CASE, THE STRUCTURE OF THE PLAN
REVEALS IN THE CONTEXT OF THE BUDGET SEVERAL KEY
ASPECTS. ONE, THE FISCAL TARGET DEPENDS UPON A

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CONTROL OF SPENDING BECAUSE THE TAX PROPOSALS BEING MOSTLY ONE-SHOT IN NATURE DO NOT RAISE SUFFICIENT REVENUE TO CAUSE A BASIC CHANGE IN THE TREND OF PUBLIC RECEIPTS AND EXPENDITURES IN RECENT YEARS. TWO, THE CONTROL OF OTHER NON-BUDGET GOVERNMENT SPENDING, MAINLY GOVERNMENT-OWNED ENTERPRISES, IS RELATED TO THE MONETARY TARGET OF A 12.5 PERCENT INCREASE OF M-2 IN 1977. THREE, THE CONTROL OF SPENDING AND MONETARY TARGET MUST BE HELD THROUGH 1977 IN ORDER TO ACHIEVE THE STABILIZATION OBJECTIVE. IN SHORT, DURATION AND CONSISTENCY OF EFFORT ARE ESSENTIAL.

4. THE DECISIVE ROLE OF FISCAL AND MONETARY POLICY
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THE BARRE PLAN IS NOT AN INCOMES POLICY PROGRAM. REFERENCES TO WAGES AND PRICES ABOUND BUT ONLY AS GUIDELINES. THAT THE GOF WILL DO ITS PART IN THIS RESPECT WITH THE HOPE THAT THE PRIVATE SECTOR WILL RESPOND IN THE NATIONAL INTEREST ABOUT SUMS UP THE INCOMES POLICY ASPECTS OF THE PLAN. PRICES ARE TO BE FROZEN ONLY TEMPORARILY. CLEARLY THE GOF IS COUNTING ON ITS FISCAL AND MONETARY TARGETS TO EXERT SUFFICIENT DISCIPLINE ACROSS THE ENTIRE ECONOMY TO BOTH REDUCE INFLATION AND TO BRING WAGE SETTLEMENTS AND PRICE BEHAVIOR CLOSER TO INCREASES

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IN REAL NATIONAL PRODUCT AND PRODUCTIVITY THAN HAS
BEEN THE CASE PARTICULARLY SINCE 1968.

A REDUCTION OF ABOUT 35 BILLION FRANCS IN PUBLIC
SPENDING AND A 3 OR 4 PERCENT REDUCTION IN THE
CURRENT RATE OF GROWTH OF THE MONEY SUPPLY (M-2),
DURING THE COURSE OF SIXTEEN MONTHS IS BY ANY
STANDARDS A RIGOROUS PROGRAM. IT IS DESIGNED TO
SQUEEZE LIQUIDITY OUT OF THE SYSTEM; AND IF
SUSTAINED, THIS SHIFT CERTAINLY MEANS A HIGHER
LEVEL OF INTEREST RATES AS ALREADY ANTICIPATED
BY THE RISE IN THE BANK OF FRANCE REDISCOUNT
RATE FROM 9.5 TO 10.5 PERCENT ON SEPTEMBER 23.

5. OUTLOOK FOR THE PLAN

FIRST OF ALL THE BARRE PLAN MUST BE ACCEPTED
BY THE NATIONAL ASSEMBLY. AS NOTED ABOVE THE
ESSENTIAL FEATURES REQUIRING PARLIAMENTARY
APPROVAL ARE IN THE BUDGET. THE REST OF THE
PROGRAM CAN BE DEBATED, CHANGED, DISCARDED OR
WHAT NOT WITHOUT AFFECTING THE ESSENTIAL BARRE
PLAN TO ANY SIGNIFICANT DEGREE. AS A BUDGET
MEASURE, ACCEPTANCE OF THE PLAN BY THE NATIONAL
ASSEMBLY SEEMS ASSURED, EVEN THOUGH MANY DEPUTIES
ARE LIKELY TO LAY THE BLAME FOR THE CURRENT STATE
OF THE ECONOMY AT GISCARD'S DOORSTEP.
THE REST OF THE PLAN SIMPLY DOESN'T MATTER
THAT MUCH.
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SECOND, THE BARRE PLAN HAS TO HAVE SUFFICIENT
PUBLIC SUPPORT TO BE EFFECTIVE. THE PLAN WILL TAKE
TIME, AT LEAST A YEAR. MANY THINGS CAN HAPPEN IN A
YEAR. IT ALSO WILL BE PERVASIVE IN THAT THE FISCAL
AND MONETARY TARGETS WILL AFFECT EVERYONE IN FRANCE.
THE BALANCE BETWEEN STABILIZATION AND EMPLOYMENT AND
LEVELS OF ECONOMIC ACTIVITY ARE DELICATE. THE
AVOIDANCE OF AN INCOMES POLICY PROBABLY HAS DEFERRED
IMMEDIATE DEBATE AND STRONG REACTIONS. THIS HAS
IN THE INITIAL STAGES OF SUCH AN EFFORT
BUT IT ALSO RUNS RISKS AS THE EFFORT PROCEEDS AND
AS THE ECONOMY BEGINS AN ADJUSTMENT THAT WILL BE,
AT BEST, UNCOMFORTABLE AND, AT WORST, PAINFUL. AS
MATTERS STAND, THE BARRE PLAN PROBABLY WILL BE
ACCEPTED GRUDGINGLY BUT SUFFICIENTLY TO BE PUT IN
MOTION.

THIS ACCEPTANCE PARTLY REFLECTS THE FACT THAT

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MANY INTEREST GROUPS AND MUCH OF THE NATION HAVE YET TO REALIZE THAT MONSIEUR BARRE IS PASSING A VERY SIZEABLE MONETARY AND FISCAL CAMEL THROUGH THE EYE OF A NEEDLE. THE MORE THE PRESS, THE UNIONS, THE PATRONAT AND OTHER GROUPS FOCUS ON TAXES, WAGES, INCOMES AND OTHER SUPPOSED BREAD AND BUTTER ISSUES, THE MORE SERENE AND REASONABLE MONSIEUR BARRE CAN BE IN TERMS OF HIS PLAN. IN SHORT, THE REAL SOCIAL AND POLITICAL BATTLES ABOUT THE BARRE PLAN HAVE YET TO DEVELOP.

THE SUCCESS OF THE PLAN AS A STABILIZATION PROGRAM DEPENDS ON MEETING OR COMING SUFFICIENTLY CLOSE TO THE FISCAL AND MONETARY TARGETS. THIS WILL DEMAND CONSISTENT AND SUSTAINED EFFORT IN ECONOMIC POLICY OF A KIND NOY YET DOMONSTRATED BY THE GISCARD PRESIDENCY. THIS PROBABLY THE GREATEST SINGLE QUESTION MARK ABOUT THE BARRE PLAN. THERE ARE SOME WHO BELIEVE THAT THE PRESENCE OF BARRE AS PRIME MINISTER WILL BE A FORCE FOR GREATER CONSISTENCY IN DOMESTIC FRENCH ECONOMIC POLICY.
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